Credits to the USSR

U.S. Objectives

-- agreement in principle that the Summit countries should work out a mechanism to manage the flow of official and officially-guaranteed credits to the USSR;

-- that the U.S. proposal to the Versailles Summit should be the basis from which the allies work in drawing up such a mechanism, so that the principle of burdensharing is strictly maintained;

-- that an independent monitoring group be established to review the effect of the mechanism and recommend appropriate changes;

Background/Analysis

Prior to, and at Versailles, the U.S. sought Summit Country support for common restrictions on official credits and guarantees to the Soviet Union. Our goals then and now are to: 1) maintain a net flow of financial resources from the USSR to the West, thus ensuring that Soviet external debt cannot build up and be used as "reverse leverage," as in Poland; 2) make Soviet resource allocation decisions (e.g., increasing defense spending) more difficult, at the margin; and 3) eliminate, ultimately, Western subsidies to Soviet growth and preparedness.

The Buckley Mission began its intensive work on this in February with a view to wrapping up at least the outlines of an agreement that leaders could bless at Versailles. In the three high-level meetings, and one meeting of technical experts, our approach stressed the need to "restrain" official credits and guarantees for reasons of "financial prudence," and to ensure that government credits don't take up the slack of a retreating private market. (Much of the groundwork,in terms of a common understanding of the Soviet financial position, has been laid.) Because of European resistance, we subordinated the "strategic" argument, i.e. that the uninhibited flow of Western credits is directly related to the increase in Soviet defense capabilities. That line of reasoning proved counterproductive with the skeptical allies, given our ability to document it only with anecdotal evidence.

A May 21 experts meeting produced agreement that a technical basis does exist for an agreement which would raise the cost -- and thus slow -- officially-backed credits to the USSR, while preserving the fundamental principle of equal burdensharing among participants. At the final high-level meeting on May 27, the U.S. tabled a draft protocol involving five elements:

1) all countries, except France, would raise cash downpayments substantially above the 15 percent now required, and shorten maturities from 8 1/2 to 5 years on the remaining financed portion.

2) France (allegedly constrained by its credit protocol with the USSR on down payments and maturities) would decrease the proportion of subsidized official financing in favor of private bank financing at market interest rates in order to increase the blended interest rate, thus balancing the policies adopted by the others;

3) countries could adopt alternative cost-raising measures as long as equivalency is maintained;

4) all countries would increase substantially their up-front fees; and

5) an independent monitoring group would be established.

The high-level Summit representatives made no decision and kicked the issue up to the heads of government at Versailles. There we achieved no meaningful progress, though the communique language, in an attempt to cloak the absence of substantive agreement, is ambiguous enough so that we can continue to push for a specific arrangement, and to provide the basis for a meaningful mechanism of credit management, given the political will to do so. The communique refers to the need to "handle cautiously financial relations with the USSR ... in such a way as to ensure they are conducted on a sound economic basis, including also the need for commercial prudence in limiting export credits." It also calls for greater exchange of information in the OECD on "all aspects of our economic, commercial, and financial relations" with the Soviet Union, and for a "periodic *ex post* review" of these relations.

The allies, to varying degrees, accept only part of our analysis regarding the danger of uninhibited credit flows to the USSR, and of our argument for restraint and reduction of subsidies. The allies either misunderstood or, much more likely, they decided the price we were asking -- a meaningful credit agreement -- was too much to pay to avoid an expansion of the sanctions (which they may have considered unlikely in any event). The question is whether they have changed their minds now that the President has demonstrated his resolve.

As during the Buckley Mission, France will be the key. The French will contend that the agreement to raise interest rates (and move the USSR and some others into the highest category) in the OECD credit arrangement will cost them more exports than the other countries, especially Germany and Japan with their lower interest rate structure. At a time of very high unemployment, Mitterrand will be very reluctant to agree to a proposal that might cut more French jobs.

The Germans are the other major actor. They derive the most benefits from their trade with Eastern Europe and the Soviet Union, and are reluctant to cut back. The FRG hid behind France on this issue, for the most part, but often appeared to play a constructive role. Indeed, the German proposal to raise the cost of credits rather than try to find a way agreeable to all for direct quantitative restrictions (our initial and still preferred thrust) served as the basis for the experts decision and the U.S. proposal. The U.K. and Italy (as well as Canada and Japan) were relatively accommodating during the Buckley Mission. A table on Summit country trade with the USSR is attached.

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Summit Countries' Trade With Soviet Bloc
1980

	Percent of Total Trade	of which USSR	Eastern Europe	Total Dollar Value (billion US $)
United States	1.2	0.4	0.8	5.7
Japan	2.1	1.7	0.4	5.3
West Germany*	6.3	2.2	4.1	24.9
France	4.0	2.4	1.6	9.6
United Kingdom	2.4	1.2	1.2	5.5
Italy	4.5	2.6	1.9	8.4
Canada	1.5	1.0	0.5	2.2

* West Germany has 1.6 percent with East Germany, 2.2 percent with USSR, and 2.5 percent with other Soviet bloc.

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